

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Ackerman Analyst: Rachel Coco Bill Number: SB 157
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 8, 2005
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Allow FTB To Offer Installment Agreements To Business Entities

SUMMARY

This bill would allow a business entity to enter into an installment agreement to satisfy a tax liability.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to provide a business entity, suffering a financial hardship, payment options to satisfy its tax liability.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment and operative January 1, 2005. This bill would specifically ratify payment arrangements entered into prior to the effective date of this bill.

POSITION

Support.

On December 1, 2004, the Franchise Tax Board voted 2-0 to sponsor the provisions of this bill.

Summary of Suggested Amendments

Amendment 1 is provided to clearly specify that the fee for establishing an installment agreement shall not be imposed on business taxpayers that enter into an arrangement or agreement prior to the later of July 1, 2005, or the effective date of this bill.

ANALYSISFEDERAL/STATE LAW

Current federal law allows installment agreements for all taxpayers, both individuals and business entities. An installment agreement is a payment arrangement that allows for the full payment of a tax debt over an extended period, instead of in one lump sum. The fee to enter into an installment agreement with the IRS is \$43.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Gerald H. Goldberg

3/9/05

Current state tax law conforms to federal law in regard to installment agreements for personal income tax (PIT) taxpayers; however, current state law lacks statutory language to allow a business entity to enter into an installment agreement.

Recently enacted legislation (SB 1100, Stats. 2004, Ch. 226) permits all taxpayers to enter into an installment agreement during tax amnesty from February 1, 2005, through May 31, 2005. In addition, SB 1100 requires the department to charge a fee to a taxpayer that enters into an installment agreement. The fee for an installment agreement entered into in 2005 is \$20.

THIS BILL

This bill would allow a business entity to enter into an installment agreement with the Franchise Tax Board (FTB) to satisfy a tax liability.

This bill also would provide that any informal payment arrangement made with FTB prior to the effective date of this bill would be treated as an installment agreement for purposes of tax amnesty. Therefore, this bill would exempt a business entity in an informal payment arrangement prior to February 1, 2005, from the amnesty penalty.

This bill also would allow installment agreements, or informal payment arrangements treated as installment agreements, entered into prior to the later of July 1, 2005, or the effective date of the bill, to be exempt from the \$20 set-up fee.

IMPLEMENTATION CONSIDERATIONS

Implementing this proposal would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

AB 3060 (Hannigan, Stats. 1986, Ch. 1361) authorized FTB to allow PIT taxpayers to enter into installment agreements.

OTHER STATES' INFORMATION

Review of *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* tax laws found that all of these states offer installment payment plans to both PIT and business entity taxpayers. The laws of these states were reviewed because their economy, business entity types, and tax laws are similar to California.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This proposal would result in the following revenue gains:

Installment Agreements For Business Entities			
Fiscal Years	2004-05	2005-06	2006-07
	+Negligible*	+Negligible*	+Minor**

*Negligible equals a gain of less than \$250,000

**Minor equals a gain of less than \$500,000

Revenue Discussion

The number of business entities that would potentially benefit from entering into installment agreements due to financial hardship range from 1,500 to 2,000 accounts. The total tax due on these accounts varies from \$3 to \$4.5 million.

The current payment default rate for personal income taxpayers in an installment agreement fell from over 40 % to less than 3% ($40\% - 3\% = 37\%$) for debtors who switched from manual payments to electronic funds transfer (EFT). Assuming that allowing business entities to enter into installment agreements would realize similar reductions in the installment agreement default rate, it is estimated that business entity collections would see a \$370,000 annual increase in collections from installment agreement accounts. ($\$3.75 \text{ million in account balances} \times 37\% \text{ improvement in the default rate} \times 80\% \text{ business participation rate divided by the 3 year payment period} = \text{approximately } \$370,000 \text{ annually}$). This amount would be partially offset by a reduction in the amount of the amnesty penalty that would have otherwise been assessed for business entities that would now benefit from entering into installment agreements prior to February 1, 2005, as a result of this bill.

Using the average total amount of tax due on business entity accounts that would potentially enter into installment agreements prior to February 1, 2005, and doubling that amount to account for the anticipated increase in accounts due to amnesty, yields \$7.5 million in total tax due on installment agreements. For this estimate we assumed that 2/3 of the tax amount would qualify for tax amnesty yielding approximately \$670,000 in accrued interest subject to the amnesty penalty. In addition, it was assumed that taxpayers that enter into installment agreements as a result of amnesty would not change their payment behavior. Therefore, the revenue impact from these individuals would only be as a result of the reduction in the assessment of the amnesty penalty. As such, imposing the 50% amnesty penalty on the amount of accrued interest would yield a reduction of \$335,000 in amnesty penalties. Assuming the amnesty penalties would have been collected over a two-year period ($\$335,000 / 2 = \$168,000 \text{ per year}$) the revenue impact would be a negligible revenue gain of \$203,000 for 2004-05 and 2005-06 and a minor gain of \$370,000 for 2006-07.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 157
As Introduced February 8, 2005

AMENDMENT 1

On page 5, line 4, strike out "installment payment" and lines 5 through 8 and insert:

the following:

(A) Informal payment arrangements treated as installment payment agreements under paragraph (1).

(B) Installment payment agreements authorized by the amendments made by the act adding this subdivision that were entered into prior to July 1, 2005, or the effective date of the act adding this subdivision, whichever is later.